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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 202

EUTERPE ECONOMOS, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

THOMAS M. WILKINS,
Counsel for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Euterpe Economos, by her attorney, Thomas M. Wilkins, Union Trust Building, Washington (5), D. C., respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in this case.

OPINIONS BELOW.

The memorandum findings of fact and opinion are included in pages 1-4 of the Appendix and the Opinion of the

Circuit Court of Appeals (R. 33) is reported at 167 F. (2d) 165.

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Fourth Circuit, a review of which is here sought, was entered on May 7, 1948 (R. 52).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A., Section 347(a)).

QUESTION PRESENTED.

Whether or not the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293, mandatorily require denial of effect for federal income tax purposes to every transfer in trust, by a mother to her sister for the benefit of the minor children of the former, of any fractional interest in and to any unincorporated restaurant business, including its name, good will, fixtures, equipment, stock in trade and leasehold of the premises wherein the business is conducted, unless there is invested in the business, capital originating directly with the beneficiaries or the trustee, or unless the beneficiaries or the trustee contribute to the control and management of the business, or otherwise perform vital additional services in the conduct of the business.

STATUTE INVOLVED.

The pertinent provisions of the Statute are printed in the Appendix to this Petition, *infra*, pp. 20-27.

STATEMENT.

With the exception of the testimony of the petitioner (Appendix, pp. 13-17) and several brief documentary exhibits, the facts were stipulated (Appendix, pp. 5-12) and were found by the Tax Court as stipulated (Appendix, pp. 1-4). They may be summarized as follows:

Euterpe Economos, hereinafter referred to as the petitioner, and her husband, Nicholas G. Economos, in the year 1937, as equal partners, carried on a "restaurant cafeteria" business in the downtown section of Washington, D. C. (Appendix 13). The husband died intestate May 25, 1937 in that City (Appendix 14, 17).

The petitioner and her husband had two children, a daughter, Chrysanthe, born June 12, 1926, and a son, Nicholas G., born July 20, 1928 (Appendix 1, 13, 20).

Under the laws of the District of Columbia, petitioner's children inherited two-thirds of the decedent's half interest in the business and assets of the said restaurant cafeteria formerly conducted by decedent in partnership with petitioner. Petitioner inherited one-third of the decedent's half interest in the said business and assets. (Appendix 1)

This business, which had a then value of approximately $16,000, was indebted to the extent of approximately $14,000. (Appendix 14, 18)

According to the uncontradicted testimony of the petitioner, the children were in the business in 1937. (Appendix 14) In order to continue the conduct of the business in the emergency created by the husband's death while the business was so heavily indebted, and thus to save the business for the children, petitioner prevailed upon the creditors to agree to free the husband's estate from any obligation if she were to assume all the debts. (Appendix 14) Following the advice of her attorney, petitioner first purchased the children's share in the business for $7500 so that she could personally assume the obligations, which she did. (Appendix 14) Later on, when petitioner had paid all the debts of the business, she felt that it was only fair to the children to reinstate them "back in the partnership," "after the emergency for which she had bought the business was removed." (Appendix 14) Petitioner considered that because of the way the business had developed and enlarged, $7500 was a very small sum to have paid the children for their share in the business. (Appendix 14) The children

were both interested in the business and always had been "in and out and helped" her "when they were at home." (Appendix 14) At the time of the trial, the daughter was in Michigan State College and was to "graduate in June in home economics which takes in restaurants also." (Appendix 13)

The parties stipulated and the Tax Court found as a fact that "petitioner created two certain trusts, as set forth in Exhibit A and B respectively." (Appendix 5).

The parties stipulated and the Tax Court found as a fact also that petitioner and the trustee under the two trusts "entered into an agreement as set forth in Exhibit C." That agreement is the partnership agreement. (Appendix 5).

The trust agreements were identical except for the names and ages of the beneficiaries. The trust agreement in the case of the daughter is Exhibit A attached to the Agreed Statement of Facts (Appendix 5). Exhibit A is copied in full on pages 6, 7 and 8 of the Appendix. The partnership agreement, which is Exhibit C attached to the Agreed Statement of Facts, is copied in full on pages 9, 10, 11 and 12 of the Appendix. Both of the trust instruments and the partnership agreement are dated January 2, 1941.

By these instruments petitioner appointed her sister Vasilike Philadelphus trustee, conveyed to her, as trustee in each, a one-fourth undivided interest in and to the restaurant business, name, good will, fixtures, equipment, stock in trade and leasehold located at 819 - 15th St., N. W., Washington, D. C. conducted under the name of Chamberlin Cafeteria. This trustee had had years of experience in the operation of restaurants. (Appendix 6, 14, 15)

The provisions of each instrument are:

1. The trustee is to receive, hold, manage, protect, sell, invest and reinvest any and all of the property comprising the trust; to collect, recover, and receive the income; and to pay out all amounts necessary to the proper conduct or administration of the trust. (Appendix 6)

2. The trustee is empowered to sell or dispose of any property and reinvest the proceeds "as in her judgment may seem wise and proper." (Appendix 6)

3 a. When the daughter becomes 23 and the son 21, each is to receive "the entire property comprising the trust."

b. In the event of the death of either child, the trustee is to pay his or her share in the principal and accumulation to his or her issue, but in default of issue, to the brother or sister. If both die without issue during the term of the trust, the trustee is to take absolute ownership of the corpus and accumulations, "it being the purpose of this agreement to avoid any part of the said one-fourth undivided interest reverting to" petitioner. In the event of the death of Vasilike Philadelphus without issue her brother A. G. Philadelphus is to take. (Appendix 7)

4. The children may not assign or anticipate the principal or income. (Appendix 7)

5. The trust is irrevocable. (Appendix 8)

6. In the event of the inability of the trustee first named to act Ralph E. Lawrence is named to act as trustee. (Appendix 8)

7. The trustee acknowledged and accepted the trust. (Appendix 8)

Exhibit C, the partnership agreement between petitioner and the trustee, recites the creation of the trusts and the conveyance thereto of an aggregate one-half undivided interest in the business. (Appendix 9)

"The parties hereto shall, as partners, engage in and conduct a restaurant cafeteria business." (Appendix 9) The term of the partnership was to be for ten years. Petitioner under the agreement assigned to the trustee an undivided equal one-half part of the gross assets. Petitioner was to devote her full time and attention to the business, but the trustee was not obligated to devote any particular

amount of time to the business of the partnership, but her activity was left to her discretion (Appendix 10).

Petitioner was entitled to receive a drawing account against her share of the profits in the sum of $750 per month. The trustee was to be entitled to receive as a drawing account on the remaining share of the profits such amount as the parties may from time to time mutually determine. The net profits or losses are to be divided equally between the parties and the account of each is to be credited or debited, share and share alike. The parties are to have the right to withdraw the profits from the partnership and in such amounts and at such times as the parties may actually determine. In the event of the death of the petitioner her interest in the business shall forthwith succeed to and belong to the trustee as such with the same powers as conferred in the deeds of trust with full right to continue the business. (Appendix 11)

In the event of the death of the first trustee, provision is made for the appointment of an alternate trustee to carry on the business. (Appendix 11)

Upon the termination of the partnership, provision is made for the division of the assets remaining among the then partners, share and share alike. (Appendix 12)

The capital account for the daughter and the son on the books showing the share of earnings and the drawings are practically identical. The capital account for the daughter is set forth on page 3 of the Appendix.

No trust income was used to support or maintain the children. (Appendix 3)

Petitioner filed gift tax returns showing a gift to each child of a one-fourth interest in the business at values of $10,500 each. (Appendix 2)

The Commissioner in determining the deficiencies included the entire income of the restaurant business as income of the petitioner. He held that the income of the trust for the year 1941 was taxable to her under Section 167, (R. 6-7) while for the year 1943 he added that the partner-

ship was not recognized for federal income tax purposes and the income was taxable to petitioner under Section 22 (a). (R. 20-21)

The Commissioner apparently abandoned his position that the partnership income was taxable in its entirety to petitioner under Section 167 and filed an amended answer to the 1941 petition raising the affirmative issue that the income was taxable to the petitioner in its entirety under Section 22 (a) of the Internal Revenue Code. (R. 11-13)

In its opinion the Tax Court held the income from the business to be taxable in its entirety to the petitioner under Section 22 (a). No mention of Section 167 was made in the "opinion." (Appendix 4)

The Circuit Court of Appeals affirmed (R. 33), disposing of petitioner's contention that her irrevocable transfers in trust of fractional interests in her business and its assets had the effect of shifting the taxability of the income arising from such transferred interests to the transferees, with the following:

> "... We think, however, that the arrangement cannot be given this effect under the rulings of the Supreme Court...." (R. 36)

Judgment was entered April 2, 1948 affirming the Tax Court's decision (R. 39). Upon application of petitioner mandate was stayed, petition for re-hearing was filed with the court on April 30, 1948 (R. 40) and was denied by the court on May 7, 1948 (R. 52).

SPECIFICATIONS OF ERRORS TO BE URGED.

(1) The Circuit Court of Appeals erred in construing the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293, as mandatorily requiring the denial of effect for federal income tax purposes to the irrevocable transfers in trust, by taxpayer to her sister for the benefit of taxpayer's minor children, of two undivided one-quarter interests in and to her unincorpo-

rated restaurant business, including all its assets, because the children and the trustee of each trust rendered no services and brought no capital to the business.

(2) The Circuit Court of Appeals erred in construing the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293 as creating a broad conclusive presumption of fact, contrary to the provision of Sections 11, 12, 161, 181, 182 and 3797 of the Internal Revenue Code, contrary to the provisions of the substantive property laws of the District of Columbia, and contrary to the stipulation of fact and the finding of the Tax Court that the two trusts were "created", the fractional interests in the business and its assets were conveyed to the trustee in each trust and that the taxpayer and the trustee of the two trusts "entered into an agreement" for the conduct of the business in partnership, thus nullifying the effect for federal income tax purposes of such irrevocable transfers in trust and the partnership agreement.

(3) The Circuit Court of Appeals erred in affirming the Tax Court's conclusions of fact in its findings (Appendix 3) which are wholly unsupported by any evidence in the record, (1) that the income of the restaurant business known as Chamberlain Cafeteria was earned by the petitioner through her own personal efforts and (2) that there was no real or genuine partnership for federal income tax purposes.

(4) The Circuit Court of Appeals erred in affirming the Tax Court's conclusion of law in its opinion (Appendix 4) which is wholly unsupported by any evidence in the record that petitioner did not actually carry on the business in partnership but conducted it as previously, by herself unaided.

REASONS FOR GRANTING THE WRIT.

1. The Circuit Court of Appeals below has decided an important question of federal law which has not been, but should be settled by this court.

The question here is: Can a trustee of two valid irrevocable trusts, existing for terms coinciding approximately with the minority of each beneficiary; wherein the income must be accumulated and distributed to each beneficiary with the corpus in approximately eight and one-half years from the date of creation; and where the grantor is without possibility of remainder, reversion, or reverter, be a "partner" in a "partnership" within the meaning of Section 3797 of the Internal Revenue Code in the conduct of unincorporated business, in which capital is a material income producing factor; where the trustee in each trust is the sister of the grantor; where the beneficiary of each trust is a minor child of the grantor; where the grantor by valid gift contributed to each trust a one-fourth undivided interest in the business and its assets; where the grantor continued to manage the business and where neither the trustee or either beneficiary contributed either services or capital in the conduct of the business?

The Circuit Court of Appeals has misconceived the application of the principles laid down by this court in the cases of *Commissioner* v. *Tower, supra,* and *Lusthaus* v. *Commissioner, supra,* by assuming that, irrespective of the good faith of the parties in giving full recognition and effect to the existence of a partnership between family members with regard to the ultimate use of the earnings and ultimate distribution thereof, no person may be regarded as a partner within the meaning of Section 3797 of the Internal Revenue Code in any business unless he performs vital additional services in the business or contributes capital originating with him in the conduct of the business. See *Mauldin* v. *Commissioner* (CCA 4), 155 F. 2d 666.

2. The decision of the Circuit Court of Appeals is in conflist with that of the Circuit Court of Appeals for the Tenth Circuit in *Armstrong* v. *Commissioner,* 143 Fed. (2d) 700 (No certiorari applied for).

In the *Armstrong case, supra,* for many years petitioner and his father had been equal partners engaged in road

construction and cattle ranching. The father died in 1937. In 1938 a new partnership agreement was prepared. The new partners were the widow and children. The then interests including those inherited in the new partnership were declared to be as follows:

Widow, 30% Petitioner, 55%

Three Children—5% each.

Petitioner made a gift to his children of his additional five percent interest in the partnership property which he inherited from his father. In order to effectuate this gift, petitioner established a trust which he set up to cover such 5% for the benefit of his two minor children in equal proportions. Petitioner made himself the trustee with all powers and management and control. The trust was irrevocable.

The Tax Court concluded that petitioner's control and management of the estate, the short trust period, the family business and relationship coupled with the fact that the son used some of the trust fund to defray his school expenses, when all considered together, constituted petitioner in reality the true owner of the trust estate.

The United States Circuit Court of Appeals for the Tenth Circuit reversed, following its own case *Jones* v. *Norris*, 122 Fed. (2d) 6, stating:

> "We do not understand that the power of management, however unlimited, may operate to bring the grantor within the sweeping provisions of Section 22(a), if by such powers he cannot derive any economic benefit therefrom, . . . the grantor retained neither the power to revoke, revest, or revert either the corpus or the income." (143 Fed. (2d) 703).

The interests involved in the *Armstrong case, supra,* and in the case below were both inherited interests. In both

cases irrevocable trusts were for the benefit of petitioner's minor children. In neither case did the interests transferred to the trust by the grantor originate with the petitioner grantor. In both cases, the grantors could not derive any economic benefit, nor did they retain power to revest, revoke or revert either the corpus or the income.

It follows, therefore, that the Circuit Court of Appeals for the Tenth Circuit decided the same question upon substantially identical facts as is involved in this case, in direct conflict with the judgment of the lower court on the question.

3. The Circuit Court of Appeals by construing the decisions of this court in the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293, as creating conclusive presumptions of fact negativing an intention to make a valid transfer in trust or to conduct the business of the restaurant in partnership with the trustee, decided this case contrary to the principles announced by this court in the case of *Heiner* v. *Donnan*, 285 U. S. 312, in violation of the due process of law clause of the Fifth Amendment to the Constitution.

4. The decision of the Circuit Court of Appeals taxing the income, which is the property of her children, to petitioner raises a federal question in a way that is probably in conflict with the applicable decision of this court in the case of *Poe* v. *Seaborn*, 282 U. S. 101. In that case, the question was who was the owner of income for the purposes of taxation under Sections 210(a) and 211(a) of the Revenue Act of 1926, which sections except as to rates correspond identically with the provisions of Sections 11 and 12 of the Internal Revenue Code quoted on page 20 of the Appendix to this Petition. In that case, although the income was earned by the appellee, Seaborn, such earnings (unlike *Lucas* v. *Earl*, 281 U. S. 111) under the laws of

the State of Washington where Seaborn and his wife resided to the extent of one-half thereof belonging to the wife under the Washington Community Property Laws, did not vest even for an instant in Seaborn. This court, therefore, held that the local laws were conclusive on the ownership of the income and hence its taxability under the federal statute. Similarly, in the instant case, the income of the business to the extent of the interest therein transferred to the trusts by petitioner, upon inception became the property of the irrevocable trusts and the beneficiaries under the property laws of the District of Columbia. Therefore, following the principles announced by this court in *Erie Railroad Company* v. *Tompkins,* 304 U. S. 64, the ownership of this income must be determined by the laws of the District of Columbia according to the ownership of the income upon its inception.

Even if petitioner did in actual fact, herself alone and unaided, produce all the income of the restaurant business with her own personal services, which she did not, in the absence of any evidence in the record to require or warrant such a conclusion, the ownership of the income from the two one-fourth undivided interests in the business and its assets did not vest in petitioner, under the laws of the District of Columbia, even for one fleeting instant. Therefore, following the decision of this court in *Poe* v. *Seaborn,* 282 U. S. 101, this fact requires the accumulated income of the trust property to be taxed to the fiduciary in accordance with the provisions of Section 161 of the Internal Revenue Code, and in accordance with the provisions of Sections 11 and 12 of the Internal Revenue Code.

ARGUMENT.

The question in this case is an important one, which should be, but has not been, settled by this court. It involves the question of the recognition of two admittedly valid trusts *inter vivos* stipulated by the parties and found as a fact by the Tax Court to have been "created". It in-

volves valid transfers to each trust "as set forth" in the stipulated exhibits (Appendix 5-12), also found as a fact by the Tax Court (Appendix 3) of a one-fourth undivided interest in the properties and going business of the restaurant, which business is of a nature in which capital is a material income-producing factor by all recognized standards. *Fairfax Mutual Wood Products Company* v. *Commissioner,* 5 T. C. 1279, 1282, *Hubbard-Ragsdale Co.* v *Dean,* 15 F. (2d) 410, affirmed 15 F. (2d) 1013, *Cotton Hotel Co.* v. *Bass,* 7 F. (2d) 900, wherein it was held that a leasehold constitutes capital, *Bowe-Burke Mining Co. et al.* v. *Willcuts,* 22 F. (2d) 204, *Vermillion Coal Co.* v. *Commissioner,* 12 B. T. A. 1161, and *Graham Flying Service* v. *Commissioner,* 167 F. (2d) 91.

Neither the findings nor opinions of the Tax Court nor the opinion of the Circuit Court of Appeals questioned the validity, existence, effect or the good faith of the trusts "created" or the transfers thereto "set forth" in the stipulated exhibits and included as part of the Tax Court's finding of fact. (Appendix 3.)

The decision of the Circuit Court of Appeals therefore has the effect of nullifying the provisions of Section 161 (Appendix 22), which require the accumulated income of the property held in trust to be taxed to the fiduciary, with exceptions not applicable here or argued as applicable here.

The decision of the Circuit Court of Appeals also has the effect of nullifying the provisions of Section 3797 of the Internal Revenue Code (Appendix 29) defining a "partnership" as including a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on and defining the term "partner" as including a member in such a syndicate, group, pool, joint venture, or organization.

Inasmuch as the stipulation and the Tax Court's finding of fact both clearly reflect the creation of the trusts, the transfers thereto of the two one-fourth undivided interests

in the restaurant business and its properties and that the petitioner and the trustee of each trust "entered into an agreement" to carry on such business "as partners" (Appendix 9), sharing the profits and losses equally (Appendix 11), and inasmuch as the business was carried on subject to that agreement (Exhibit C, Appendix 9-12) subjecting the unchallenged trust property to the risks and hazards of the business, a "partnership" resulted therefrom within the meaning of Section 3797 of the Internal Revenue Code, the petitioner and the trustee conducted themselves as "partners" within the meaning of Section 3797 of the Internal Revenue Code and the income of the trust property is required by Section 161 of the Internal Revenue Code to be taxed to the fiduciary and may not be taxed to the petitioner, unless, of course, the whole transaction constituted a sham to defraud the taxing authorities.

There is not any evidence in the record as in the cases of *Tower* v. *Commissioner*, *supra* and *Commissioner* v. *Lusthaus*, *supra*, from which the inference might be reasonably drawn that the arrangement or any part of it was a sham. There was no proof that the "end result" was that the income of the interests transferred, continued, after the creation of the trusts and partnership, to be used for family purposes, or for the benefit of the petitioner. The uncontradicted evidence, the stipulation of the parties and the finding of fact of the Tax Court all showed conclusively that the entire income of the transferred interests, which was not required for expenses of operation, was accumulated in the business for the sole benefit of the beneficiaries, to be distributed to them upon the termination of the trusts after a period of only about eight and one-half years from the time of the creation of the trusts. Under those circumstances it becomes wholly immaterial, for the purposes of testing the good faith of the arrangement, to consider whether or not the trustee or the beneficiaries or any of them contributed services of a vital character or capital originating with them, or participated in the active

conduct and management of the business. The trust instruments specifically provided that under no circumstances could the income or corpus of either trust ever revest or revert to the petitioner. (Exhibit A, Par. 3b, Appendix 7.) Under those circumstances neither the provisions of section 167 of the Internal Revenue Code or the doctrine in the case of *Helvering* v. *Clifford*, 309 U. S. 331, is applicable to the facts in the case.

No question as to the effect for income tax purposes of a transfer in trust of an interest in an unincorporated business was involved or decided in the case of *Commissioner* v. *Tower, supra* or in the case of *Lusthaus* v. *Commissioner, supra.* Nor was the definition of "partnership" or "partner" under Section 3797 of the Internal Revenue Code raised, considered or decided in either of these cases.

The decision of the Circuit Court of Appeals seems to be predicated on the premise that the *Tower* and *Lusthaus* cases made drastic changes in the substantive laws of partnerships for the purpose of administering the income tax laws. The principles outlined in those cases do not purport to prevent the formation of valid bona fide partnerships in businesses where capital is a material income producing factor, merely because of the failure of the alleged partner to perform vital services and failure of such partner to invest capital originating with him. To so hold is to construe these cases as modifying the federal law of income taxation and the local law of property, because the statute taxes income to its owner. That is to say, the statute taxes income to the person in whom, for local property purposes, the income vests immediately upon its inception. *Poe* v. *Seaborn, supra. Lucas* v. *Earl, supra,* requires no different view.

Earl had a contract with his wife for the division of *his income* with her. It had to be his first before his wife's interest in it vested. His income arose from contracts with third persons, with whom his wife had no contractional relationship. In the instant case the income of the trusts

became the income of the trusts and the beneficiaries, not because it became petitioner's income first, but because the trusts had an absolute interest under the property laws of the District of Columbia in the business itself and assets of the business which produced the income. The beneficiaries are protected from abuse by the laws of the District of Columbia. To say that all of the income of the business is petitioner's property and hence taxable to her, merely because she devoted all of her time to the management and conduct of the business, ignores the decision of this court in the case of *Paul* v. *Cullum*, 132 U. S. 539, 550, in which this court held that it is entirely competent for partners to determine, as between themselves, the basis upon which profits shall be divided and losses borne, without regard to their respective contributions, whether of money, labor, or experience, to the common stock of the partnership. It is elementary that an unincorporated business in which capital is a material income producing factor, may be carried on as a valid partnership regardless of the respective contributions of capital, labor or control. The income of a corporation is not the income of its managing stockholder with a half interest, merely because the other half interest is held in a valid trust for the benefit of such stockholder's minor children who received their stock from such stockholder by gift and who contributed no services. Why then should *Lucas* v. *Earl*, *supra*, render the income of the identical business, the income of the managing partner, when conducted as a partnership?

Section 3797 of the Internal Revenue Code defines a "person" to mean and include an individual, a trust estate, partnership, company, or corporation. In the absence of any federal statute requiring otherwise, the income of the trust from its half ownership in the going business, should be taxed to its owner, the trust, under the provisions of Sections 11 and 12 of the Internal Revenue Code.

We do not think that this court in the *Tower* and *Lusthaus* cases intended to usurp the constitutional powers

of Congress by judicially legislating changes in the federal income tax laws or the local property laws as indicated by the decision of the Circuit Court of Appeals below. We believe that this court merely intended by those decisions to affirm judicially the finding of the Tax Court in specific cases, regarding the inferences drawn by the Tax Court as reasonably justified by *all* the factors in the transactions.

In both of those cases no real change in the economic relationship of the husbands and their wives to the income in question was brought about by the partnership, principally because the income continued after as before to be devoted to the same family uses. This "end result" justified the Tax Court in looking to find some offsetting evidence of good faith. Finding none, it was held to have been justified in its holding that no real transfer had been made.

We believe that the result would have been entirely different had the wives contributed capital originating with themselves or had they contributed vital additional services. But the findings of the Tax Court in regard to those factors were *negative* or lacking. It does not necessarily follow that without some such *positive* evidence of disregard of a pretended partnership as the continued use of its income for the same family purposes after as before, courts must in all family partnership cases conclusively presume that the partnership is of no effect for income tax purposes solely because proof of contribution of capital, vital services and control by the disputed partners was *negative*. Those *negative* factors did not operate to make the presumption of bad faith arising from the disregard of the partnership any stronger, they merely failed to remove or offset the presumption of bad faith arising from the disregard of the partnership. It is elementary that such negative factors do not constitute tests of the existence or nonexistence of partnerships in which capital is a material income producing factor. *Paul* v. *Cullum, supra.*

We believe that the disregard of the partnership by the pretended partners through the continued use of its income

for the same family purposes was an indispensable *positive* factor in justifying the Tax Court's findings in those cases.

There was no such *positive* proof of disregard of the relationship in the instant case that would justify the Tax Court in looking for some positive offsetting evidence of good faith. The existence in the instant case of the irrevocable trusts to which the admittedly completed transfers of fractional interests in the going business and assets were made and the accumulation of the income for the benefit of and protection of the minor children to be distributed to them with the corpus in a few short years coinciding with the reaching of his majority, in the case of the son, and coinciding with the reaching of the age of 23, in the case of the daughter, in no sense corresponds to the *positive* factor of disregard of the partnership through the continued employment of the income for the same family purposes existing in the *Tower* and *Lusthaus* cases.

Under the circumstances, the tests of good faith in the instant case turn on whether the trusts come within the rule in *Helvering* v. *Clifford, supra* rather than whether the partnership comes within the rule in the *Tower* and *Lusthaus* cases. The instant case is removed from the application of the *Clifford* doctrine by the fact that the trust is irrevocable, that it is to terminate within only eight and one-half years from the date of its creation and that under no circumstances can the petitioner continue to use or ever use the income of the trust, as before, for her own or for family purposes. In the instant case a real change was brought about by the entire transaction. Before the formation of the trust and partnership petitioner was free to spend the entire income of the business for her own or family purposes. After the creation of the trust and the partnership she could no longer spend the entire income from the business as she pleased. Her freedom of use then became limited to the income of her retained one-half interest, while she is required to accumulate the income on the half representing the income from the children's in-

terest, or if she distributes any such income to the trustee, the trustee is required to hold the income for the benefit of the children and distribute it to them together with the corpus at the end of the short term of the trust.

CONCLUSION.

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Counsel for Petitioner.

APPENDIX.

INTERNAL REVENUE CODE PROVISIONS
SUBCHAPTER B—GENERAL PROVISIONS

PART I—RATES OF TAX

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 4 per centum of the amount of the net income in excess of the credits against net income provided in section 25. (For alternative tax if gross income from certain sources is $3,000 or less, see section 400.)

[The foregoing provisions are applicable to the taxable year 1941. The provisions applicable for the year 1943 are identical except that the normal tax rate is 6 per centum instead of 4 per centum. The alternative brackets are omitted.]

SEC. 12. SURTAX ON INDIVIDUALS.

Sec. 12. (a) DEFINITION OF "SURTAX NET INCOME."—As used in this section the term "surtax net income" means the amount of the net income in excess of the credits against net income provided in section 25 (b).

Sec. 12. (b) RATES OF SURTAX.—There shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual the surtax shown in the following table:

[The foregoing provisions are identical both as to 1941 and 1943. The surtax rate schedule is omitted to conserve space.]

SUPPLEMENT E—ESTATES AND TRUSTS.

SEC. 161. IMPOSITION OF TAX.

(a) APPLICATION OF TAX.—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) COMPUTATION AND PAYMENT.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

(c) CROSS REFERENCE.—

For return made by beneficiary, see section 142.

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23(o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

SEC. 167. INCOME FOR BENEFIT OF GRANTOR [AS AMENDED BY SEC. 134(a), REV. ACT 1943].

* * * * * * * * * *

(c) Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting

as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor.

[Sec. 134(b), Rev. Act 1943, provides as follows:

["(b) TAXABLE YEARS TO WHICH APPLICABLE.—

["(1) GENERAL RULE.—Except as provided in paragraph (2), the amendments made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1942, unless a taxable year of the trust beginning in 1942 ends within a taxable year of the grantor beginning in 1943, in which case, except as provided in paragraph (2), such amendments shall not be applicable to such taxable year of the grantor.

["(2) RETROACTIVE EFFECT.—The amendments made by subsection (a) shall also be applicable with respect to all taxable years to which such amendments are not made applicable under paragraph (1), in the same manner as if such amendments had been a part of the revenue laws applicable to such taxable years, but only if there are filed with the Commissioner (in accordance with regulations prescribed by him with the approval of the Secretary) at such time and by such persons as may be prescribed under such regulations, signed consents that there shall be paid, at such time as the Commissioner may prescribe, all of the taxes under Chapter 1 of the Internal Revenue Code or under the corre-

sponding provisions of prior revenue laws which would have been paid for the taxable years concerned if such amendments had been a part of the revenue laws applicable to such taxable years.

["(3) DEFICIENCIES AND OVERPAYMENTS.—The period of limitations provided in sections 275 and 276 of the Internal Revenue Code or corresponding provisions of a prior revenue law on making of assessments and the beginning of distraint or a proceeding in court for collection shall with respect to any deficiency resulting from any such consents include one year immediately after the date such consents were filed, and such assessment and collection may be made notwithstanding any provision of the internal revenue laws or any rule of law which would otherwise prevent such assessment and collection. The period within which claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, with respect to any overpayment by the grantor resulting from the consents shall include one year immediately after the date of the filing of the consents, and credit or refund may be allowed or made notwithstanding any provision or rule of law (other than this subsection, section 3760 of the Internal Revenue Code or a corresponding provision of prior law, relating to closing agreements, and section 3761 of the Internal Revenue Code or a corresponding provision of prior law, relating to compromises) which would otherwise prevent such credit or refund. No interest shall be allowed or paid on any overpayment, or assessed on any deficiency, resulting from the application of paragraph (2) of this subsection."]

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS [AS AMENDED BY SEC. 150(g), REV. ACT 1942].

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME [AS AMENDED BY SEC. 150(g), REV. ACT 1942].

(a) GENERAL RULE.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) SEGREGATION OF ITEMS.—

(1) CAPITAL GAINS AND LOSSES.—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) ORDINARY NET INCOME OR LOSS.—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or